



Office of the Secretary  
Public Company Accounting Oversight Board  
1666 K Street, N.W.  
Washington, DC 20006-2803

12 September 2011

**RE: PCAOB Rulemaking Docket Matter No. 035, *Proposed Standards for Attestation Engagements Related to Broker and Dealer Compliance or Exemption Reports Required by the U.S. Securities and Exchange Commission and Related Amendments to PCAOB Standards***

Dear Sir:

We appreciate the opportunity to respond to the Public Company Accounting Oversight Board's (the "Board") *Proposed Standards for Attestation Engagements Related to Broker and Dealer Compliance or Exemption Reports Required by the U.S. Securities and Exchange Commission and Related Amendments to PCAOB Standards* (the "proposed standards").

Overall, we support the proposed standards and believe they will provide a consistent framework for the performance of the work required by the Securities and Exchange Commission's (the "Commission") Broker-Dealer Reports proposal (the "proposed rule"). While supportive, we believe further clarification of the following areas is necessary in finalizing the proposed standards for issuance. In the remainder of our letter, we have organized our observations into the following topical areas:

- The definition and application of material non-compliance
- Interaction of internal control over financial reporting and internal control over compliance
- The proposed effective date
- Use of other auditors

#### **The definition and application of material non-compliance**

One of the purposes of the auditors' examination and review procedures outlined by the proposed standards is to detect instances that, individually or in aggregate, would result in material noncompliance with the Financial Responsibility Rules. As discussed in our response to the Commission's proposed rule, we believe that additional guidance is needed in identifying an appropriate framework for evaluating the materiality of such instances, including any quantitative or qualitative measures that may be appropriate, in order to achieve consistent application in the context of each of the Financial Responsibility Rules. In particular, we believe that additional guidance is necessary in the following areas:



- *Elements of the Rule which are not quantitative in nature (e.g., the possession or control requirement under Exchange Act Rule 15c3-3, or the customer statements requirement).* Applying a materiality threshold is more challenging in these areas where "violations" cannot be measured in terms of a relationship to financial statement audit materiality levels. Therefore, a framework involving qualitative considerations must be developed in order to ensure consistent application among broker-dealers, between broker-dealers and their auditors, and among auditing firms.
- *Whether an adjustment that exceeds the financial statement audit materiality levels made to the broker-dealer's regulatory calculations should be considered an instance of material non-compliance, even if no Rule violation resulted from the error.* For example, if a broker-dealer misapplied the guidance related to (i) a calculation under Rule 15c3-1 or (ii) the reserve requirements Rule 15c3-3, resulting in a quantitatively material adjustment to the broker-dealer's net capital or reserve requirement, would these adjustments be considered an instance of material non-compliance even if the broker-dealer's excess net capital or reserve bank account was adequate to cover the revised calculations?

### **Interaction of internal control over financial reporting and internal control over compliance**

As noted in our response to the Commission's proposed rule, broker-dealers will *not* be required to assess the effectiveness of internal control over financial reporting, as issuers are required to do in connection with the requirements of the Sarbanes-Oxley Act of 2002. Instead, the proposed rule would require the Compliance Report to include a statement as to whether the broker-dealer has established and maintained a system of internal control to provide the broker-dealer with reasonable assurance that any instances of material non-compliance with the Financial Responsibility Rules will be prevented or detected on a timely basis. We note that many aspects of the Financial Responsibility Rules (specifically, Rules 15c3-1 and 15c3-3) are derived in part from the financial reporting process. Because of these interactions with the financial reporting process, we believe it would be helpful if the PCAOB could coordinate with the SEC to provide guidance clarifying their expectations with respect to procedures that are considered necessary for the auditor to perform in order to evaluate whether internal control over compliance with the Financial Responsibility Rules is effective.

We also request that the PCAOB coordinate with the SEC to provide further guidance around the evaluation of deficiencies in internal control over compliance when material weaknesses are identified in connection with the financial statement audit pursuant to AU 325, *Communications about Control Deficiencies in an Audit of Financial Statements*; specifically, whether the PCAOB believes that all material weaknesses in internal control over financial reporting identified by the auditor during the financial statement audit should necessarily be considered to be material weaknesses in internal control over compliance with the Financial Responsibility Rules. For example, the auditor may identify a material misstatement in a non-allowable asset during the performance of its financial statement audit and determine that this material misstatement constitutes a material weakness. However, as the asset is not an allowable asset for the purpose of the calculation of net capital under 15c3-1, the resulting adjustment would have no impact on the broker-dealer's net capital or excess net capital under 15c3-1. Would this material weakness in internal control over financial reporting be considered a material weakness in





internal control over compliance with the Financial Responsibility Rules? Conversely, would the SEC and PCAOB expect that all instances of material non-compliance or all material weaknesses in internal control over compliance with the Financial Responsibility Rules be considered by the auditor to be material weaknesses in internal control over financial reporting under AU 325?

### **The proposed effective date**

As noted in our response to the Commission's proposed rule, the effective date of the proposed standards for fiscal years ending on or after September 15, 2012 is inconsistent with the effective date for the Commission's proposed rule for fiscal years ending on or after December 15, 2011. We are concerned that the effective date of the Commission's proposed rule may not be practicable as broker-dealers will need time for effective implementation of the proposed rule, including training, to ensure quality working practices around the identification, evaluation, and remediation of potential instances of non-compliance. In addition, we note that for auditors, engagement planning and interim testing procedures for most December 31, 2011 audit engagements are already underway, and we believe audit firms should be provided additional time to incorporate the changes into their audit methodologies and to complete related training programs prior to the beginning of the year in which the Commission's proposed rule would apply.

We also note that the effective date of the Commission's proposed rule would require the auditor to apply the existing PCAOB standards for audits performed during the transition period, and then adopt the proposed standards for audits performed after the transition period, which would be inefficient and costly for broker-dealers and their auditors. Therefore, we believe that the effective date for the Commission's proposed rule should be delayed to apply to fiscal years ending on or after September 15, 2012, which would align with the effective date of the PCAOB's proposed standards.

### **Use of other auditors**

We note the following question posed by the PCAOB on page A4-15:

*"When a broker or dealer has multiple divisions or branches, do situations exist in which the auditor that is engaged to perform the examination engagement uses the work of other auditors? If so, should the proposed examination standard establish requirements that govern the use of the work of other auditors?"*

We believe that there will be instances where the auditor may use the work of another auditor; therefore, we believe the proposed standard should include the concept embedded in paragraph 14 of AS 9, *Audit Planning*, that limits this work to selecting locations when using another auditor under AU 543, *Part of Audit Performed by Other Independent Auditors*.



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We appreciate the opportunity to express our views and would be pleased to discuss our comments or answer any questions that the PCAOB staff or the Board may have. Please contact Brian R. Richson (973-236-5615) or Derrick T. Stiebler (973-236-4904) regarding our submission.

Sincerely,

*Brian R. Richson*